

§ 229.303 (Item 303) Management's discussion and analysis of financial condition and results of operations.

(a) *Objective.* The objective of the discussion and analysis is to provide material information relevant to an assessment of the financial condition and results of operations of the registrant including an evaluation of the amounts and certainty of cash flows from operations and from outside sources. The discussion and analysis must focus specifically on material events and uncertainties known to management that are reasonably likely to cause reported financial information not to be necessarily indicative of future operating results or of future financial condition. This includes descriptions and amounts of matters that have had a material impact on reported operations, as well as matters that are reasonably likely based on management's assessment to have a material impact on future operations. The discussion and analysis must be of the financial statements and other statistical data that the registrant believes will enhance a reader's understanding of the registrant's financial condition, cash flows and other changes in financial condition and results of operations. A discussion and analysis that meets the requirements of this paragraph (a) is expected to better allow investors to view the registrant from management's perspective.

(b) *Full fiscal years.* The discussion of financial condition, changes in financial condition and results of operations must provide information as specified in paragraphs (b)(1) through (3) of this section and such other information that the registrant believes to be necessary to an understanding of its financial condition, changes in financial condition and results of operations. Where the financial statements reflect material changes from period-to-period in one or more line items, including where material changes within a line item offset one another, describe the underlying reasons for these material changes in quantitative and qualitative terms. Where in the registrant's judgment a discussion of segment information and/or of other subdivisions (*e.g.*, geographic areas, product lines) of the registrant's business would be nec-

essary to an understanding of such business, the discussion must focus on each relevant reportable segment and/or other subdivision of the business and on the registrant as a whole.

(1) *Liquidity and capital resources.* Analyze the registrant's ability to generate and obtain adequate amounts of cash to meet its requirements and its plans for cash in the short-term (*i.e.*, the next 12 months from the most recent fiscal period end required to be presented) and separately in the long-term (*i.e.*, beyond the next 12 months). The discussion should analyze material cash requirements from known contractual and other obligations. Such disclosures must specify the type of obligation and the relevant time period for the related cash requirements. As part of this analysis, provide the information in paragraphs (b)(1)(i) and (ii) of this section.

(i) *Liquidity.* Identify any known trends or any known demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant's liquidity increasing or decreasing in any material way. If a material deficiency is identified, indicate the course of action that the registrant has taken or proposes to take to remedy the deficiency. Also identify and separately describe internal and external sources of liquidity, and briefly discuss any material unused sources of liquid assets.

(ii) *Capital resources.* (A) Describe the registrant's material cash requirements, including commitments for capital expenditures, as of the end of the latest fiscal period, the anticipated source of funds needed to satisfy such cash requirements and the general purpose of such requirements.

(B) Describe any known material trends, favorable or unfavorable, in the registrant's capital resources. Indicate any reasonably likely material changes in the mix and relative cost of such resources. The discussion must consider changes among equity, debt, and any off-balance sheet financing arrangements.

(2) *Results of operations.* (i) Describe any unusual or infrequent events or transactions or any significant economic changes that materially affected the amount of reported income from

continuing operations and, in each case, indicate the extent to which income was so affected. In addition, describe any other significant components of revenues or expenses that, in the registrant's judgment, would be material to an understanding of the registrant's results of operations.

(ii) Describe any known trends or uncertainties that have had or that are reasonably likely to have a material favorable or unfavorable impact on net sales or revenues or income from continuing operations. If the registrant knows of events that are reasonably likely to cause a material change in the relationship between costs and revenues (such as known or reasonably likely future increases in costs of labor or materials or price increases or inventory adjustments), the change in the relationship must be disclosed.

(iii) If the statement of comprehensive income presents material changes from period to period in net sales or revenue, if applicable, describe the extent to which such changes are attributable to changes in prices or to changes in the volume or amount of goods or services being sold or to the introduction of new products or services.

(3) *Critical accounting estimates.* Critical accounting estimates are those estimates made in accordance with generally accepted accounting principles that involve a significant level of estimation uncertainty and have had or are reasonably likely to have a material impact on the financial condition or results of operations of the registrant. Provide qualitative and quantitative information necessary to understand the estimation uncertainty and the impact the critical accounting estimate has had or is reasonably likely to have on financial condition or results of operations to the extent the information is material and reasonably available. This information should include why each critical accounting estimate is subject to uncertainty and, to the extent the information is material and reasonably available, how much each estimate and/or assumption has changed over a relevant period, and the sensitivity of the reported amount to the methods, assumptions and estimates underlying its calculation.

Instructions to paragraph (b): 1. Generally, the discussion must cover the periods covered by the financial statements included in the filing and the registrant may use any presentation that in the registrant's judgment enhances a reader's understanding. A smaller reporting company's discussion must cover the two-year period required in §§ 210.8-01 through 210.8-08 of this chapter (Article 8 of Regulation S-X) and may use any presentation that in the registrant's judgment enhances a reader's understanding. For registrants providing financial statements covering three years in a filing, discussion about the earliest of the three years may be omitted if such discussion was already included in the registrant's prior filings on EDGAR that required disclosure in compliance with § 229.303 (Item 303 of Regulation S-K), provided that registrants electing not to include a discussion of the earliest year must include a statement that identifies the location in the prior filing where the omitted discussion may be found. An emerging growth company, as defined in § 230.405 of this chapter (Rule 405 of the Securities Act) or § 240.12b-2 of this chapter (Rule 12b-2 of the Exchange Act), may provide the discussion required in paragraph (b) of this section for its two most recent fiscal years if, pursuant to Section 7(a) of the Securities Act of 1933 (15 U.S.C. 77g(a)), it provides audited financial statements for two years in a Securities Act registration statement for the initial public offering of the emerging growth company's common equity securities.

2. If the reasons underlying a material change in one line item in the financial statements also relate to other line items, no repetition of such reasons in the discussion is required and a line-by-line analysis of the financial statements as a whole is neither required nor generally appropriate. Registrants need not recite the amounts of changes from period to period if they are readily computable from the financial statements. The discussion must not merely repeat numerical data contained in the financial statements.

3. Provide the analysis in a format that facilitates easy understanding and

that supplements, and does not duplicate, disclosure already provided in the filing. For critical accounting estimates, this disclosure must supplement, but not duplicate, the description of accounting policies or other disclosures in the notes to the financial statements.

4. For the liquidity and capital resources disclosure, discussion of material cash requirements from known contractual obligations may include, for example, lease obligations, purchase obligations, or other liabilities reflected on the registrant's balance sheet. Except where it is otherwise clear from the discussion, the registrant must discuss those balance sheet conditions or income or cash flow items which the registrant believes may be indicators of its liquidity condition.

5. Where financial statements presented or incorporated by reference in the registration statement are required by § 210.4-08(e)(3) of this chapter (Rule 4-08(e)(3) of Regulation S-X) to include disclosure of restrictions on the ability of both consolidated and unconsolidated subsidiaries to transfer funds to the registrant in the form of cash dividends, loans or advances, the discussion of liquidity must include a discussion of the nature and extent of such restrictions and the impact such restrictions have had or are reasonably likely to have on the ability of the parent company to meet its cash obligations.

6. Any forward-looking information supplied is expressly covered by the safe harbor rule for projections. See 17 CFR 230.175 [Rule 175 under the Securities Act], 17 CFR 240.3b-6 [Rule 3b-6 under the Exchange Act], and Securities Act Release No. 6084 (June 25, 1979).

7. All references to the registrant in the discussion and in this section mean the registrant and its subsidiaries consolidated.

8. Discussion of commitments or obligations, including contingent obligations, arising from arrangements with unconsolidated entities or persons that have or are reasonably likely to have a material current or future effect on a registrant's financial condition, changes in financial condition, revenues or expenses, results of operations,

liquidity, cash requirements or capital resources must be provided even when the arrangement results in no obligations being reported in the registrant's consolidated balance sheets. Such off-balance sheet arrangements may include: Guarantees; retained or contingent interests in assets transferred; contractual arrangements that support the credit, liquidity or market risk for transferred assets; obligations that arise or could arise from variable interests held in an unconsolidated entity; or obligations related to derivative instruments that are both indexed to and classified in a registrant's own equity under U.S. GAAP.

9. If the registrant is a foreign private issuer, briefly discuss any pertinent governmental economic, fiscal, monetary, or political policies or factors that have materially affected or could materially affect, directly or indirectly, its operations or investments by United States nationals. The discussion must also consider the impact of hyperinflation if hyperinflation has occurred in any of the periods for which audited financial statements or unaudited interim financial statements are filed. See § 210.3-20(c) of this chapter (Rule 3-20(c) of Regulation S-X) for a discussion of cumulative inflation rates that may trigger the requirement in this instruction 9 to this paragraph (b).

10. If the registrant is a foreign private issuer, the discussion must focus on the primary financial statements presented in the registration statement or report. The foreign private issuer must refer to the reconciliation to United States generally accepted accounting principles and discuss any aspects of the difference between foreign and United States generally accepted accounting principles, not discussed in the reconciliation, that the registrant believes are necessary for an understanding of the financial statements as a whole, if applicable.

11. The term *statement of comprehensive income* is as defined in § 210.1-02 of this chapter (Rule 1-02 of Regulation S-X).

(c) *Interim periods.* If interim period financial statements are included or are required to be included by 17 CFR 210.3 [Article 3 of Regulation S-X], a

management's discussion and analysis of the financial condition and results of operations must be provided so as to enable the reader to assess material changes in financial condition and results of operations between the periods specified in paragraphs (c)(1) and (2) of this section. The discussion and analysis must include a discussion of material changes in those items specifically listed in paragraph (b) of this section.

(1) *Material changes in financial condition.* Discuss any material changes in financial condition from the end of the preceding fiscal year to the date of the most recent interim balance sheet provided. If the interim financial statements include an interim balance sheet as of the corresponding interim date of the preceding fiscal year, any material changes in financial condition from that date to the date of the most recent interim balance sheet provided also must be discussed. If discussions of changes from both the end and the corresponding interim date of the preceding fiscal year are required, the discussions may be combined at the discretion of the registrant.

(2) *Material changes in results of operations.* (i) Discuss any material changes in the registrant's results of operations with respect to the most recent fiscal year-to-date period for which a statement of comprehensive income is provided and the corresponding year-to-date period of the preceding fiscal year.

(ii) Discuss any material changes in the registrant's results of operations with respect to either the most recent quarter for which a statement of comprehensive income is provided and the corresponding quarter for the preceding fiscal year or, in the alternative, the most recent quarter for which a statement of comprehensive income is provided and the immediately preceding sequential quarter. If the latter immediately preceding sequential quarter is discussed, then provide in summary form the financial information for that immediately preceding sequential quarter that is subject of the discussion or identify the registrant's prior filings on EDGAR that present such information. If there is a change in the form of presentation from period to period that forms the basis of comparison from previous peri-

ods provided pursuant to this paragraph, the registrant must discuss the reasons for changing the basis of comparison and provide both comparisons in the first filing in which the change is made.

Instructions to paragraph (c): 1. If interim financial statements are presented together with financial statements for full fiscal years, the discussion of the interim financial information must be prepared pursuant to this paragraph (c) and the discussion of the full fiscal year's information must be prepared pursuant to paragraph (b) of this section. Such discussions may be combined. Instructions 2, 3, 4, 6, 8, and 11 to paragraph (b) of this section apply to this paragraph (c).

2. The registrant's discussion of material changes in results of operations must identify any significant elements of the registrant's income or loss from continuing operations which do not arise from or are not necessarily representative of the registrant's ongoing business.

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§ 229.304 (Item 304) Changes in and disagreements with accountants on accounting and financial disclosure.

(a)(1) If during the registrant's two most recent fiscal years or any subsequent interim period, an independent accountant who was previously engaged as the principal accountant to audit the registrant's financial statements, or an independent accountant who was previously engaged to audit a significant subsidiary and on whom the principal accountant expressed reliance in its report, has resigned (or indicated it has declined to stand for reelection after the completion of the current audit) or was dismissed, then the registrant shall:

(i) State whether the former accountant resigned, declined to stand for reelection or was dismissed and the date thereof.

(ii) State whether the principal accountant's report on the financial statements for either of the past two years contained an adverse opinion or a disclaimer of opinion, or was qualified or modified as to uncertainty, audit scope, or accounting principles; and also describe the nature of each such